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FEDERAL COMMUNICATIONS COMMISSION
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October 11, 1994

BY HAND

Mr. William F. Caton,
Acting Secretary,
Federal Communications Commission,
1919 M Street, N.W.,
Washington, D.C. 20554.

Re: Ex Parte Presentations
PP Docket No. 93-253

Dear Mr. Caton:

On behalf of Roland A. Hernandez and pursuant to Section 1.1206(a)(2) of the Commission's Rules, this letter constitutes notice that, on October 5, Roland A. Hernandez, President, Interspan Communications Corp., and Robert B. Nolan, Vice President, Goldman, Sachs & Co., met with (a) Commissioner James H. Quello and Rudolfo M. Baca, Legal Advisor to Commissioner Quello; (b) Chairman Reed E. Hundt and Sara Seidman, Special Assistant to the General Counsel; and (c) Mary McManus, Legal Advisor to Commissioner Susan Ness. In addition, Peter D. Kiernan, III, Partner, Goldman, Sachs & Co., met with those listed in clause (b) and Terence M. O'Toole, Partner, Goldman, Sachs & Co., met with those listed in clauses (a) and (b). On October 6, Roland A. Hernandez and Donald G. Erb, Vice President, Goldman, Sachs & Co., met with Dr. Robert M. Pepper, Chief, Office of Plans and Policy, Sara Seidman, Special Assistant to the General Counsel, and Donald H. Gips, Deputy Chief, Office of Plans and Policy; Commissioner Andrew C. Barrett and Lisa B. Smith, Legal Advisor to Commissioner Barrett; Commissioner Rachelle Chong and Jill Lockett, Senior Advisor to Commissioner Chong; and Anthony L. Williams, Chief, Office of Small Business Activities. The purpose of the meetings

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was to discuss issues in the Commission's Competitive Bidding rule making proceeding.^{1/}

Mr. Hernandez made the following points:

1. The Commission Has Crafted Rules That In Large Part Meet The Mark.

In most respects, the Commission has successfully created a framework in the Fifth Report and Order in PP Docket No. 93-253, FCC 94-111 (July 15, 1994) ("Order") that will allow viable minority-owned businesses to successfully participate in the broadband auction process. There remain a few hurdles to obtaining financing, however, that the FCC must address to meet its policy goal of ensuring that licenses are "disseminated to . . . remedy the serious underrepresentation of minorities . . . in the provision of telecommunications services." Order at ¶ 2.

2. The Commission Should Raise the Bidding Credit to 40 Percent

The most significant barrier to entry for minorities is financing. In fashioning its auction rules, the Commission recognized that minorities generally do not have ready access to capital markets and that their costs of capital are higher. See Order at ¶¶ 97-110. To compensate for these significant barriers, the Commission chose a 25 percent bidding credit. Now, in light of the extraordinary prices bidders paid in the narrowband auctions, the Commission should increase the bidding credit from 25 to 40 percent for a minority-owned small business bidder.

^{1/} Mr. Hernandez requests a waiver of 47 C.F.R. § 1.1206(a)(2) to the extent it may be required. The Commission officials with whom Mr. Hernandez met until late in the afternoon on October 6 asked that he reduce his presentation to writing. To comply with this request, more time was needed than the rule permits. To complicate matters, Mr. Hernandez resides in California and returned on Friday, October 7. The Commission was on holiday Monday, October 10, so the next available filing date was October 11.

3. The Commission Should Maintain the Requirement that Designated Entities Invest Their Own Capital

Given the legitimate concerns about creating rules which may invite "shams" and "fronts" to compete in the bidding process, the Commission should maintain the requirement that a designated entity invest at least 25 percent of the unconditional or "green" equity in a minority-controlled applicant. The Commission should not allow applicants who are financed solely by others to qualify as minority-owned businesses by contributing so-called "sweat equity."

It is fundamental to the auction's success that minorities remain in the business for the long-term in order to diversify ownership in the telecommunications marketplace. Unless the FCC requires true, at-risk capital by the designated entity, the process will fail. A person with his/her own capital at risk will work to ensure the business succeeds. He or she will also be much less tempted to realize financial gain by selling or "flipping" his/her interest at the earliest opportunity.

The FCC has repeatedly stated that the entrepreneur's block was not created as a mechanism for persons without capital of their own to obtain something for nothing and serve as fronts for other entities. See, e.g., Order at ¶ 168. The auction rules should not allow some minorities with no investment capital of their own to secure financial backing to get rich quick. If the Commission lowers the amount of unconditional equity which a designated entity must invest from 25 percent, it must keep the amount high enough^{2/} so that a designated entity has his/her own capital at risk. The Commission's goals will be realized only when minorities hold a significant portion of equity. Otherwise, the Commission's rules would have the unintended result of creating perverse incentives and attracting designated entities interested more in quick financial gain than long term involvement in the telecommunications industry. This result would mock the Commission's goals and the public interest in a diversified telecommunications industry.

^{2/} The Commission should set the number no lower than 15 percent.

4. The Commission Should Extend the Five-Year Holding and Limited Transfer Period to Seven Years and Reduce the Bidding Credit Penalty Conterminously

The auction rules now allow an entity that qualifies as an entrepreneurial business (\$125 million in gross revenues and less than \$500 million in total assets) to transfer its license after five years to an entity that would not qualify to bid in the entrepreneurs' blocks without incurring any penalty other than payment of the unpaid balance in full before the Commission will approve the sale. By contrast, if a minority-owned small business transfers its license after five but before 10 years, it must reimburse the government for the amount of the bidding credit before the Commission will approve the transfer.

This disparity handicaps designated entities because potential strategic investors will be able to assume control of the PCS business at an earlier stage in their investment if they invest in non-minority businesses. The likely result of the disparity will be that the investors will ally themselves with companies with which they have established, long-term relationships, instead of designated entities.

To correct this imbalance, the Commission should extend the holding period for all entrepreneurial block bidders to seven years. The "unjust enrichment" penalties for recouping the bidding credits should be similarly adjusted and reduced over time, similar to the rules adopted for narrowband PCS on September 21, 1994 in the Erratum to Third Memorandum Opinion and Order and Further Notice of Proposed Rulemaking in PP Docket No. 93-253, FCC 94-219 (August 17, 1994). Accordingly, the Commission should adopt the following schedule in assessing forfeiture penalties: for a transfer of license in the first five years of the license term the forfeiture would be 100 percent of the value of the bidding credit; in year six, the forfeiture would be 50 percent; in year seven, the forfeiture would be 25 percent, after which no further penalty would be assessed.

5. The Commission Should Maintain The Small Business Administration (SBA) Affiliation Rules

The Commission has been deluged with requests to change various aspects of the affiliation rules. However, if the Commission alters the rules, it will create uncertainty as to how they may be interpreted and applied. The SBA rules have been fleshed out over the years and a

well-defined body of precedent has been established which provides certainty -- a highly-valued factor for the business community given the major and massive uncertainties surrounding broadband PCS. The Commission has established the rules to achieve its policy goals and the SBA model provides, in the Commission's words, "a solid foundation." Order at ¶ 202. Accordingly, the Commission should maintain the SBA affiliation rules.

6. The Commission Should Maintain The Rule Calculating Ownership Interests On A Fully-Diluted Basis

The Commission struck the right balance in deciding that certain ownership interests such as stock options, convertible debentures and agreements to merge will "generally be considered to have a present effect on the power to control or own an interest" Order at ¶ 207. Nothing in the record calls into question the Commission's rationale that "such ownership interests will almost always have the potential either to impact the ability of a designated entity to control a company or to diminish a designated entity's financial stake in the venture." Second Memorandum of Opinion and Order in PP Docket No. 93-253, FCC 94-215 (August 15, 1994) at ¶ 132. Otherwise, as the Commission wisely foresees, nondilution would lead inescapably to a loss of control of PCS businesses by designated entities. It would also remove the important requirement that minorities assume their share of the personal risk associated with such businesses. The Commission's waiver request process for rare circumstances not implicating these concerns should provide ample protection for applicants that are unduly burdened by the rule. Id. The rule calculating ownership interests on a fully-diluted basis is sound, and the Commission should not alter it.

An original and one copy of this letter are being submitted to the Secretary to include in the above-

Mr. William F. Caton

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referenced file. Should any questions arise in connection with this notice, please do not hesitate to contact the undersigned.

Respectfully submitted,

By 
Patricia Diaz Dennis
Ari Q. Fitzgerald

Attorneys for
Roland A. Hernandez

cc: The Honorable James H. Quello
Rudolfo M. Baca, Esq.
The Honorable Reed E. Hundt
Sara Seidman, Attorney-at-Law
Mary McManus, Attorney-at-Law
Dr. Robert M. Pepper
Donald H. Gips
The Honorable Andrew C. Barrett
Lisa B. Smith, Attorney-at-Law
The Honorable Rachelle Chong
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